

2. (a) Explain why firms might wish to collude.

[10 marks]

Answers **may** include:

- definitions of collusion, oligopoly
- diagram to show the benefits of collusion in terms of monopoly profits
- an explanation of the reasons why firms might collude such as: to increase profits, limit competition, limit uncertainties about the behaviour of rivals and how they might collude: formal collusion (forming a cartel), informal collusion (price leadership)
- examples of collusion.

(b) Discuss the view that governments should always try to prevent a monopoly occurring in a market.

[15 marks]

N.B. It should be noted that definitions, theory, and examples that have already been given in part (a), and then referred to in part (b) should be rewarded.

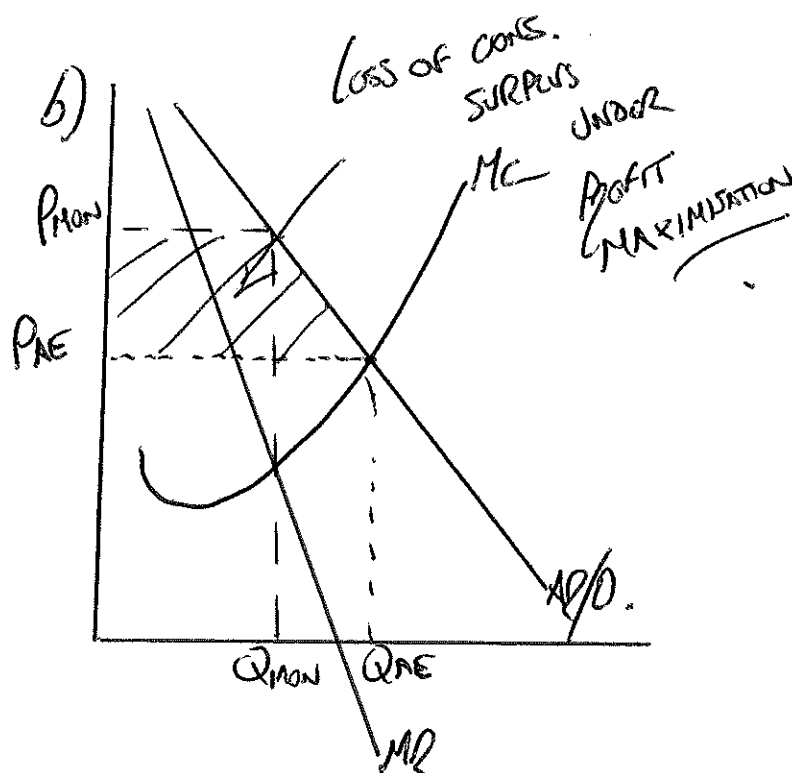
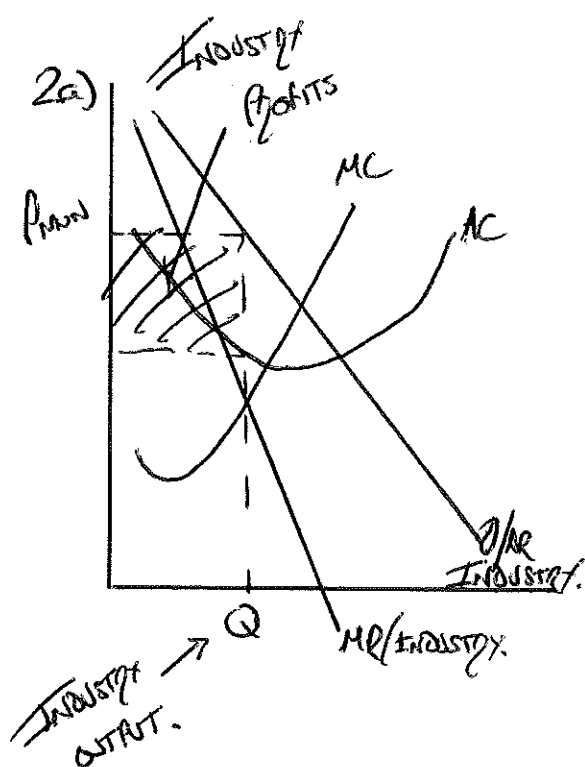
Answers **may** include:

- definition of a monopoly
- diagram to show a monopoly
- an explanation of the advantages of monopoly (natural monopoly, R&D) and disadvantages (loss of economic efficiency, higher prices, lower quantities)
- examples of government intervention, such as anti-monopoly legislation, regulation of natural monopoly
- synthesis or evaluation (discussion).

Discussion **may** include: a consideration of why governments should or should not try to prevent a monopoly.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.



2. (a) Using diagrams, explain why a perfectly competitive firm can make economic (abnormal) profit only in the short run. [10 marks]

Answers **may** include:

- definitions of perfect competition, economic (abnormal) profit and short run
- diagrams of economic (abnormal) profit in the short run and normal profit (zero economic profit) in the long run
- an explanation of how economic (abnormal) profit acts as a signal for new firms to enter the market, shifting market supply to the right until normal profits are restored
- examples of markets where this might occur.

- (b) Discuss the consequences of a perfectly competitive industry becoming a monopoly. [15 marks]

N.B. It should be noted that definitions, theory, and examples that have already been given in part (a), and then referred to in part (b) should be rewarded.

Answers **may** include:

- definitions of monopoly and perfect competition
- diagrams to compare monopoly with perfect competition
- an explanation of how price, output, welfare, costs and efficiency would be affected when a perfectly competitive industry becomes a monopoly
- examples of instances to which this might be, or has been, applied
- synthesis or evaluation (discuss).

Command term

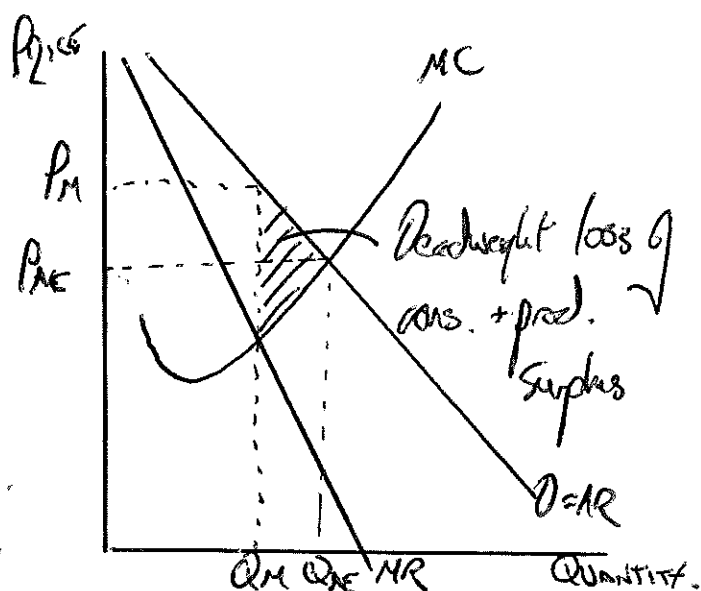
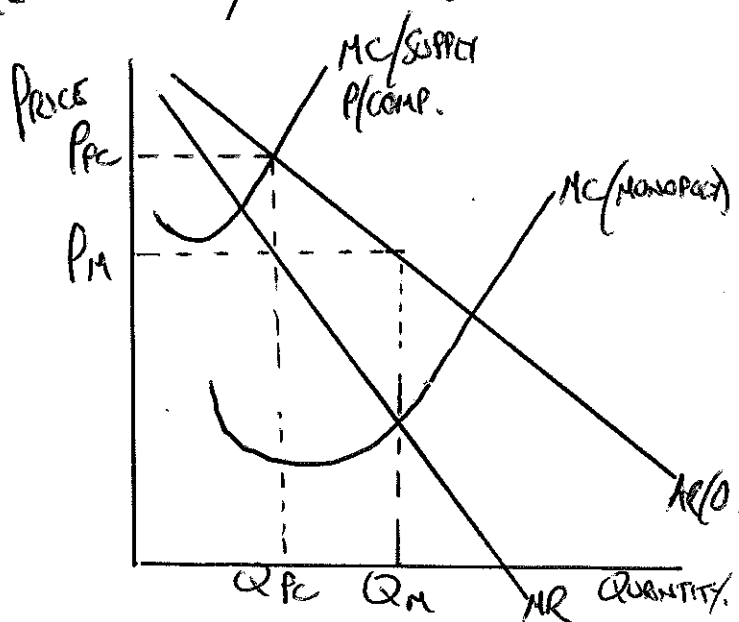
"Discuss" requires candidates to offer a considered and balanced review that includes a range of arguments, factors or hypotheses. For example, candidates may point to advantages of monopoly such as economies of scale, research and development, *etc.*

Discussion **may** include: the advantages and disadvantages of a market becoming a monopoly with an overall assessment.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

RELEVANT DIAGRAMS TO PART B)



1. (a) Explain why firms in monopolistic competition can make economic profit in the short run only. [10 marks]

Answers may include:

- definitions of monopolistic competition, economic profit, the short run, the long run
- theory of monopolistic competition; assumptions, short-run economic profit and in the long run the entry of new firms and zero economic profit
- diagrams to show economic profit, zero economic profit in monopolistic competition
- examples of monopolistic competition.

- (b) Compare and contrast the market structures of monopoly and monopolistic competition. [15 marks]

N.B. It should be noted that definitions, theory, and examples that have already been given in part (a), and then referred to in part (b) should be rewarded.

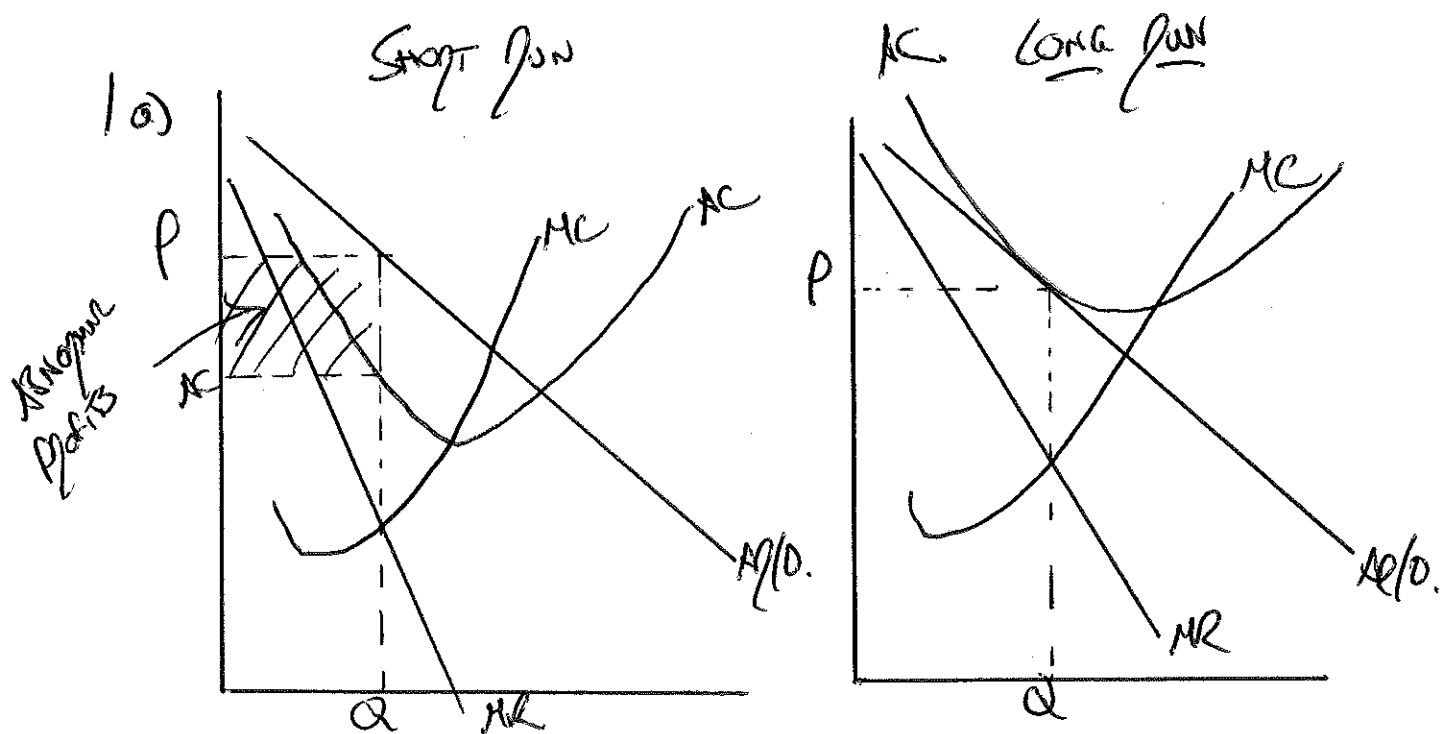
Answers may include:

- definitions of monopoly, monopolistic competition
- theory of monopoly and monopolistic competition
- diagrams to show monopoly and monopolistic competition
- examples of monopoly and monopolistic competition
- synthesis or evaluation (compare and contrast).

Points of similarity may include: downward sloping demand curves, price makers, profit maximization assumed ($MC = MR$), economic profit possible in the short run, lack of productive and allocative efficiency.

Points of difference may include: number of producers, economies of scale for monopoly, ease of entry and exit, size of firms, degree of market power, economic profit in the short run and long run, effects on consumers.

Opinions or conclusions should be presented clearly and supported by appropriate examples.



2. (a) Using a diagram, explain why firms in monopolistic competition are neither allocatively nor productively efficient. [10 marks]

Answers may include:

- definitions of monopolistic competition, allocative efficiency and productive efficiency
- diagram of monopolistic competition
- an explanation of monopolistic competition showing that it cannot be productively efficient because it does not produce where $MC = ATC$ or allocatively efficient because it does not produce where $MC = AR$
- examples to support the explanation given.

- (b) Examine the view that the market for food is more beneficial to consumers if dominated by a monopoly retailer (supermarket) rather than by a large number of small shops operating under monopolistic competition. [15 marks]

N.B. It should be noted that definitions, theory, and examples that have already been given in part (a), and then referred to in part (b) should be rewarded.

Answers may include:

- definitions of monopoly, monopolistic competition
- an explanation of theory of the firm related to retail markets, how both monopoly and monopolistic competition have their advantages and disadvantages in terms of costs, price and output
- diagram to show the possible impact on consumers under monopoly and monopolistic competition in terms of price
- examples of relevant market structures
- synthesis and evaluation (examine).

Command term

“Examine” requires candidates to consider an argument or concept in a way that uncovers the assumptions and interrelationships of the issue.

Factors considered may include: the effects on efficiency and customer service, welfare effects, price and output, and economies of scale.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.